

MORTGAGE BROKER EXAMINATION MANUAL



State of Washington

DEPARTMENT OF FINANCIAL INSTITUTIONS

Division of Consumer Services

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I. INTRODUCTION

This draft examination manual is a guide to assist the Department of Financial Institutions' Examiners, and provide standards for Independent Certified Professionals and Specialists, (Examiners) for examinations of Mortgage Brokers (MB). The manual is subject to change based on changes in examination techniques, mortgage broker statutes and rules, and applicable changes to federal regulations. This manual can also be used by the mortgage broker industry as a guideline for compliance.

II. PRE-EXAMINATION PHASE

The Department of Financial Institutions (the Department) assigns an Examiner in Charge (EIC), or designee, to conduct various discovery activities as part of the pre-examination phase. The EIC identifies possible licensing concerns, bonding requirements, annual assessment payments, complaint history, tips, licensed loan originators and registered independent contractors, and other related activities. The EIC uses this information to focus the examination scope on those areas that present the greatest degree of risk. If applicable, the EIC also reviews previous examination reports to reveal prior deficiencies and corrective actions that should have been resolved. The pre-examination setup and various discovery activities conducted include, but are not limited to the following:

A. Administrative Set-Up for Examination

Administrative Staff:

- 1) Work with examination scheduler to determine when a licensee is due for an examination.
- 2) Deliver entry letter with Designated Broker Questionnaire (DBQ) and Loan List Request at least thirty days prior to the examination entry date.
- 3) If the Designated Broker (DB) informs the Department that an examination by a Professional or Specialist has already been performed, the DB requests that the Professional or Specialist provide a copy of the report with supporting documentation of apparent violations, if applicable, directly to the Department from the Professional or Specialist.
- 4) Gather informational documents* and place electronic copies on secure media.
- 5) Inform EIC of examination.



Designated Brokers
Questionnaire



Loan List Request

(Double-Click to Open)

*The informational documents are various items that are available in the office that may not necessarily be available to the EIC in the field. These documents include bond and any applicable riders; important information from the Department's licensing file, complaint history, and financial statements.

B. Contacting the Licensee

EIC:

- 1) Make contact with licensee to ensure receipt of the Entry Letter and DBQ.
- 2) Answer any questions the DB may have.
- 3) Request the loan list so that the EIC can make a loan list selection which will help determine the time and number of examiners needed to complete the examination.
- 4) Verify location of examination and business hours of that location.

- 5) Inform the DB that a trust account examination will take place.
 - Request adequate assistance if the trust records are maintained electronically.
- 6) Request necessary accommodations including workstations, printer and Internet access, copier access, and other items deemed necessary.

C. Examiner Set-Up for Examination

EIC:

- 1) Obtain electronic templates for the Report of Examination (ROE), Examination Hours Recapitulation, Travel Billing Spreadsheet, (for out-of-state examinations) and the Examination Worksheet.
- 2) Ensure materials are stored on secure media.

D. Washington State Agency Verifications

EIC:

- 1) Obtain the licensee's Uniform Business Identifier (UBI) from the licensing file or the Department of Licensing (DOL) website.
- 2) Conduct research at DOL to assure that the company's legal and trade names adhere to Washington State licensing requirements and that the licenses are current and active.
- 3) Review the licensee's registration with the Secretary of State and Department of Revenue (DOR).
- 4) Record any variations between the information provided in the licensing file and information contained at DOL, Secretary of State, and DOR in the ROE.

E. DFI Mortgage Broker Licensing File

EIC:

- 1) Review the licensing file to gain familiarity with the company.
- 2) Check for missing information that may need to be obtained onsite.
- 3) Review any office closures or address changes.
- 4) Review any regulatory enforcement actions against the company.
- 5) Check ownership and verify that it has been updated if changes have occurred.
- 6) Review information contained in the STAR database*.
- 7) Review the list of Loan Originators, and registered Independent Contractors and verify that it matches what was reported in the DBQ.
- 8) Note the bank account numbers on record for the general and trust account. These will be verified onsite.
- 9) Re-verify the background information on the officers and designated broker

*STAR is the internal database that DFI maintains which includes much of the licensing information on the licensee. It should match any information contained in the paper licensing file, as well as provide additional information.

F. Licensee Standing with Other States

EIC:

- 1) Verify that the licensee is in good standing with other states in which it maintains a license.
- 2) Assure there have been no license suspensions, revocations, or restrictions by other states.

G. Surety Bond

EIC:

- 1) Verify the bond amount is adequate*.
- 2) Verify the name and address of the licensee.
- 3) Assure the surety company is authorized to conduct activity in Washington, by checking with the Insurance Commissioner at www.insurance.wa.gov.

*The bond amount is verified by checking the monthly average number of loan originators. The required amounts can be found in WAC 208-660-175.



How to Calculate
Bond Worksheet

(Double-Click to Open)

H. Complaint Review

EIC:

- 1) Review any files in the STAR Enforcement database to discover new complaints and tips not yet processed.
- 2) Request full loan files from the licensee for each open complaint found.
- 3) Collect all documentation necessary from Enforcement*.
- 4) Complete the Complaint Analysis Form and submit a copy to the Enforcement Unit Complaints Coordinator.

*Once onsite, the examiners review the complaint(s) by performing a full loan file review for compliance with all statutes. If review of complaints reveals violations of statute the scope of the examination may need to be expanded to identify other instances of similar violations. If open complaints related to the non-payment of third party providers exist, a review of the trust account and associated sub ledgers is to be completed.



Complaint Analysis -
Instructions



Complaint Analysis

(Double-Click to Open)

I. Annual Assessment Review

EIC:

- 1) Verify that the MB annual license assessment fee has been paid*.
- 2) Verify that any loan originator annual license assessments are also paid.

*Requirements for licensing fees and annual assessment payments are found in RCW 19.146.210, RCW 19.146.310 and WAC 208-660-550(C)(2)(3).

J. Mortgage Broker Annual Report Verification

EIC:

- 1) Verify the annual report* filed by the MB includes:

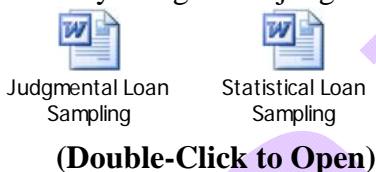
- The total number of residential mortgage loans secured by Washington real estate that the MB originated and closed in the prior calendar year.
- The total dollar volume (principal loan amounts) of the residential mortgage loans secured by Washington real estate that you originated and closed in the prior calendar year.
- 2) Reconcile the annual report to the information contained in the DBQ and other reports provided by the licensee.

*A licensed MB is required to file an annual report in a form prescribed by the Director by May 1st of each year, beginning in 2008. The annual report must cover the prior calendar year from January 1st to December 31st.

K. Loan List and Sample Selection

EIC:

- 1) Request a sample of brokered loans by using either judgmental or statistical sampling.



- 2) Request a small sample of declined files (if applicable).

Using Schedule O (from the DBQ) the EIC selects the sample of loans to review from the entire population of loans from the examination period. The loan sample is selected by using a “statistical” or a combination of “statistical” and “judgmental” sampling techniques. Once received, Schedule O is sorted at the EIC’s discretion to reveal trends and possible high risk lending factors that may bring cause for a judgmental sample.

If Schedule O is not available, the EIC requests a loan list that covers the period of review. At a minimum, the licensee provides the loan list in a Microsoft Excel spreadsheet format with the following separate column headings:

- Loan number or ID
- Last name
- First name
- Property address
- City
- State
- Zip Code
- Program (Conventional, Non-Conventional, VA, FHA, Reverse, Commercial)
- Loan purpose (Refinance, Purchase, HELOC, Fixed 2nd)
- Type (e.g. 2 yr Arm, fixed)
- LTV
- Mortgage Broker fees
- Other Mortgage Broker fees
- Yield spread premium income
- Rate
- Term

- Settlement date
- Loan Originator last name
- Loan Originator license number
- Status (funded, withdrawn, denied)
- Occupancy
- Lien position
- Loan amount



Preliminary Loan List

(Double-Click to Open)

L. Travel Arrangements

EIC:

- 1) Make travel arrangements and hotel accommodations for all members of the examination team
- 2) Obtain travel directions related to the location of the airport, licensee, hotel, and rental car company.

Refer to DFI's internal policies regarding travel before making arrangements.

Regulatory Authority 1) RCW 19.146.235(8) and WAC 208-660-550(6)

M. Scope of the Examination

EIC:

- 1) Prepare the Exam Scope Memo.
- 2) Forward the Exam Scope Memo to the Examination Supervisor for approval.
- 3) Meet with other examiners about the scope of the examination before commencing the examination.

The Exam Scope Memo is a document that the EIC prepares before beginning the exam. This memo summarizes what has been discovered in the pre-examination phase and any special instruction for the examiners during the onsite examination phase. The findings and discussion derived from the preparation activities may form the scope of the examination. The scope should be limited to:

- A review of trust accounting records to ensure compliance with the Washington State Mortgage Broker Practices Act, RCW 19.146 (the Act).
- Loan file review to determine compliance with the Act and applicable federal regulations covering the business of mortgage brokering and lending.
- Interviews for the purpose of understanding the mortgage broker's business and solicitation practices, transactional events, disclosure compliance, complaint resolution, or determining specific compliance with the Act and the attendant rules;
- Review of general business books and records, including employee records to determine compliance with the Act.

If during the examination the EIC determines that the findings clearly identify a need to expand the scope* of the examination, the Department will provide you with five business days' written notice. The expanded examination may include a different location and may go beyond the initial five year time limit.

*Reasons for expanding the scope include:

- When the Department finds a violation of trust accounting
- When violations of the prohibited practices section of the Act are discovered. See RCW 19.146.0201 for prohibited practices.
- When there are clear systemic violations requiring greater review than is possible in a routine examination.

Regulatory Authority 1) RCW 19.146.235(5)

III. EXAMINATION PHASE

A. Onsite Introductions

Upon arrival the EIC makes introductions of the examiners to the onsite point of contact which is typically the DB for the organization. The EIC schedules a time with the DB to discuss the business operation and records so that the EIC understands the MB business operation.

B. Setting up Accommodations

The EIC ensures that the examiners have the resources available to perform the examination which may include internet connectivity, office supplies, copy machine, printer, telephone, and other accommodations within the facility.

C. Onsite Examiner Meeting

Once the examiner(s) are setup and prepared to proceed with the examination, the EIC provides instructions to the examiner(s). The instructions may include, but are not limited to:

- Discuss the scope of the examination.
- Review potential areas of concern found during examination preparation.
- Verify the loan files requested are present.
- Verify the requested denied files are present.
- Arrange all of the simultaneous 1st and 2nd mortgage loan files together by borrower last name.
- Discuss complaints and tips received by the enforcement section.

D. EIC Review of the Designated Broker's Questionnaire

The EIC reviews the DBQ or may assign parts of the questionnaire to be reviewed by another examiner. The EIC reviews the DBQ for elements that give insight to the operations and safety and soundness of the company. The DBQ can reveal potential risk factors; violations of state or federal statutes; and practices that may be harmful to consumers.

E. Expectations of the Examiner, Professional or Specialist

1. Every deficiency or apparent violation cited in the examination should be supported with documentation, often called the workpapers, so that the review examiner can verify the validity of the findings. If, after discussing the findings with the DB, the Examiner, Professional or Specialist (Examiner) is challenged about the violation or deficiencies noted, the Examiner should maintain a

professional demeanor and not peruse an argument with the DB. The Examiner should instruct the DB to include their points in a written response to the Department.

2. When the examiner realizes they are spending too much time on a project or on an issue because of inadequate information, the DB or MB should be contacted immediately and provided a written list of the items required to complete the analysis with a due date. The Examiner Supervisor must be notified if it will affect the scheduling of the examination or if the scope of the examination must be altered.
3. The examiner has the responsibility of writing a clear, concise, and comprehensive report of examination that cites the appropriate statutes, and is free of grammatical and spelling errors. A template for the Report of Examination is provided:



Draft Report of Examination

(Double-Click to Open)

F. Business Practices

1. Credit Report

Examiner:

- 1) Review the credit report to assure it is the earliest report that was obtained for this borrower. This can be verified by reviewing the inquiries on the credit report.
- 2) Enter the date of the earliest credit report on the MB Examiner Workbook.
- 3) Investigate the mortgage trade lines for real estate activity.

The credit report date determines when the MB or loan originator on behalf of the MB has gathered sufficient information to make application. This may be a trigger for early disclosures when the property address is known.

If the credit report was pulled for a prequalification (the property address is not available), this action may not constitute an "application" to trigger RESPA disclosures. However, ECOA or FCRA requirements for notifications would still apply. Note - The taking of an application whether or not the property is known will require an ECOA notification and credit score notice to be delivered to borrowers.

For a refinance or purchase application that is not a prequalification, the credit report may be enough to constitute an "application."

2. Loan Application (Fannie Mae Form 1003 and Freddie Mac Form 65)

Examiner:

- 1) Review the application to assure that all sections were filled out correctly and that the product requested on the application is what the borrower received.
- 2) Insure no sections are left blank without an explanation. (A section may be marked N/A)
- 3) Review all applications in the file to assure that the borrower received disclosures for each type of loan product applied for.

- 4) Enter the following information on the MB Examiner Worksheet.
 - Borrower name
 - Date (of interviewer's signature)
 - Interviewer's name, company name, and address
 - Loan Originator and License number

In most cases a loan originator (on behalf of a mortgage broker) will input loan application information directly into an automated loan-processing program (Calyx, Genesis, and Byte are some examples). These programs are designed to interface with credit reporting companies and underwriting systems. This substantially cuts down on the processing time of an application and gives a loan originator an underwriting response and credit determination quickly. These systems primarily apply to conforming loan transactions. Non-conforming transactions and government loans are more detailed but many companies have developed automated systems that work the same way. See the *Loan Application Review Guidelines* below for further guidance.



Loan Application
Review Guidelines

(Double-Click to Open)

3. Initial Disclosures Covered Under the Act

a. *Initial Truth in Lending Act (TILA) Disclosure*

Examiner:

- 1) Enter date on the Examiner Worksheet and compare to the application or credit report date. (Must be delivered within three business days)
- 2) Review for accuracy by comparing information to other documents in the file.
- 3) Verify the APR using the OCC APR calculator.
- 4) Review for the inclusion of the following:

Item Required	Authority
Name of licensee/preparer/Broker	(Broker) Regulation Z, Part 3500, 226.18(a)
Annual Percentage Rate	RCW 19.146.030(2)(a) and 226.18(e)
Finance charge	RCW 19.146.030(2)(a) and 226.18(d)
Amount financed	RCW 19.146.030(2)(a) and 226.18(b)
Total of payments	RCW 19.146.030(2)(a) and 226.18(h)
Number of payments or Payment Schedule	RCW 19.146.030(2)(a) or Payment Schedule 226.18(g)
Amount of each payment or Payment Schedule	RCW 19.146.030(2)(a) or Payment Schedule 226.18(g)
Variable rate feature	RCW 19.146.030(2)(a), 226.18(f)(2)(i) and 226.19(b)(1)(2)
Prepayment penalty*	226.18(k)
Demand feature	226.18(i)
Insurances required to obtain credit	226.18(n)
Security being held	226.18(m)
Late charge	226.18(l)
Contract Reference	226.18(p)

Assumption statement	226.18(q)
Itemization of Amount Financed	226.18(c)

*A mortgage broker that does not disclose a prepayment penalty and then contracts with a lender that provides a prepayment penalty, where the mortgage broker receives a Yield Spread Premium (YSP) in part for the loan having a prepayment penalty without disclosure to the borrower may be in violation of 19.146.0201(7).

According to 19.146.030(2)(a), the written disclosure shall contain: the annual percentage rate; finance charge; amount financed; total amount of all payments; number of payments; amount of each payment; amount of points or prepaid interest; the conditions and terms under which any loan terms may change between the time of disclosure and closing of the loan. In addition, if a variable rate it must contain: the circumstances under which the rate may increase; any limitation on the increase; the effect of an increase; and an example of the payment terms resulting from an increase.

Examiners should be aware that this section may be interpreted as:

- *Points* shall mean loan discount points which reduce the nominal rate and any mortgage broker fee.
- *Prepaid interest* is the daily interest calculation controlled by the nominal interest rate.
- *Conditions* apply to the loan type; 2 yr. ARM, 3 yr. ARM, fixed Rate, balloon or demand feature, and lien position.
- *Terms* relate to the number of months or years of the loan.

The TILA form is not required by RCW 19.146.030(2)(a), but the disclosure requirements are similar. The TILA disclosure is the most widely used disclosure throughout the industry for disclosure of the annual percentage rate (APR), finance charge, amount financed, total amount of all payments, number of payments, amount of each payment, amount of points or prepaid interest. If the TILA disclosure is used it will meet the requirements of RCW 19.146.030(2)(a).

b. Itemized Fees and Cost or a Good Faith Estimate (GFE) of Settlement Costs

Examiner:

- 1) Review the accuracy of fees
- 2) Verify the form was provided to the borrower within three days of application
- 3) Verify that all required content is present on the disclosure*
- 4) Compare these fees to those charged to the customer at closing (Check for re-disclosure)
- 5) Check for a disclosed Yield Spread Premium (YSP)
 - Verify the YSP on the Settlement Statement and report discrepancies**
 - Gather data on the use of YSPs and include in the final report.
 - How often is a YSP used?
 - Does it actually reduce borrower(s) closing costs (review rate sheets)?

*Disclosure using a GFE is not required. If a loan originator or mortgage broker chooses not to use the GFE form, they must provide a substitute form that meets the following requirements:

- 1) A full written disclosure containing an itemization and explanation of all fees and cost that the borrower is required to pay.

- 2) The itemized cost of any credit report, appraisal, title report, title insurance policy, mortgage insurance, escrow fee, property tax, insurance, structural or pest inspection, and any other third-party provider's cost associated with the residential mortgage loan.

Disclosure through good faith estimates of settlement services and special information booklets in compliance with the requirements of the Real Estate Settlement Procedures Act³ meets the requirements of the two items above.

**Examiners will verify if YSP is disclosed on the GFE according to the instructions in Regulation X, Appendix B, fact 13 which states in part, . . . “Also, any other fee or payment received by the mortgage broker from either the lender or the borrower arising from the initial funding transaction, including a servicing release premium or yield spread premium, is to be noted on the Good Faith Estimate and listed in the 800 series of the [HUD-1](#) Settlement Statement and the Good Faith Estimate.

The Yield Spread Premium should be disclosed in a manner that will allow consumers to make a side-by-side comparison of the line item cost on the good faith estimate and HUD-1 settlement statements. If YSP appears on the settlement statement but was not disclosed on the GFE, the company will be found in violation of RESPA. The words “Yield Spread Premium” and the dollar amounts should be used on the Good Faith Estimate. The YSP should be clearly disclosed so that the consumer can understand the nature of the premium being paid to the broker in exchange for a higher interest rate or margin on adjustable rate mortgages.

Regulatory authority: 1) RCW 19.146.030(1); 2) RCW 19.146.030(2) (b); 3) 12 U.S.C. Sec. 2601 and 24 C.F.R. Sec 3500

c. Lock-In Agreement

Examiner:

- 1) Verify that a lock-in agreement was provided to the borrower(s) within three days of the lock-in being entered between the mortgage broker and lender.
- 2) Verify it contains the cost, terms, duration, and conditions of any lock-in agreement entered into by the borrower(s).
- 3) Check for re-disclosure if applicable*.

*If a lock-in agreement with a borrower is reached after the initial disclosure is sent, the mortgage broker or loan originator must deliver or send by first-class mail to the borrower a written confirmation of the terms of the lock-in agreement no less than three business days thereafter including Saturdays.

d. Model Disclosure Form (If Used)

Examiner:

- 1) Verify that DFI's “Model Disclosure Form” (or a suitable substitute*) was provided to the applicant within three days of application.
- 2) Verify that the “Model Disclosure Form” was filled out correctly.

Certain statements are required to be provided to the borrower(s) within three business days of application. The Department has created a model form that includes these statements. It is available

to the industry at http://www.dfi.wa.gov/cs/mortgage_forms.htm. When completed appropriately the form meets the requirements of RCW 19.146.030(2) (e) and (f).

*Although most licensees use the Department's form, they do have the option to create their own; however, the form must meet the disclosure requirements set forth in RCW 19.146.030(2)(e) and (f).

e. Adjustable Rate Mortgage (ARM) Disclosure

Examiner:

- 1) Verify that the disclosure was given within three days of application.
- 2) Verify the contents required under RCW 19.146.030(2)(a) are included.
- 3) Verify the contents of the form meet the federal standards.

Regulation Z sets forth very specific requirements for the ARM disclosure. Most companies use automated forms systems, but occasionally those systems generate inaccurate disclosures; therefore, a sample form must be reviewed carefully for compliance with Regulation Z*.

*Regulatory Authority: 1) Regulation Z, Truth in Lending (226.19(b)) and RCW 19.146.030(2)(a).

f. Additional Federal Disclosures

(i) Required Pamphlets

Special Information Booklet

The lender shall provide the special information booklet by delivering it or placing it in the mail to the applicant not later than three business days (as that term is defined in [§3500.2](#)) after the application is received or prepared. However, if the lender denies the borrower's application for credit before the end of the three-business-day period, then the lender need not provide the booklet to the borrower. If a borrower uses a mortgage broker, the mortgage broker shall distribute the special information booklet and the lender need not do so. The intent of this provision is that the applicant receives the special information booklet at the earliest possible date.

When your Home is on the Line

In the case of a federally related mortgage loan involving an open-ended credit plan, as defined in [§226.2\(a\)\(20\) of Regulation Z](#) (12 CFR), a lender or mortgage broker that provides the borrower with a copy of the brochure entitled "When Your Home is On the Line: What You Should Know About Home Equity Lines of Credit," or any successor brochure issued by the Board of Governors of the Federal Reserve System, is deemed to be in compliance with this section.

Regulatory Authority 1) Reg. X part 3500.6(a)(1) and (2)

(ii) RESPA Servicing Disclosure Statement

Examiner:

- 1) Verify this disclosure was given (if required) within three days of application.

The RESPA Servicing Disclosure statement is required if a consumer applies for a mortgage servicing loan from any lender, dealer, or mortgage broker who anticipates using table funding.

Regulatory Authority: Regulation X, 3500.21(b)(1)

(iii) Affiliated Business Arrangement (AFBA) Disclosure

Examiner:

- 1) Review the DBQ and organizational chart for affiliated businesses.
- 2) When reviewing files, assure that the AFBA disclosure was given to the consumer in any case where one of the affiliated was used.

The AFBA disclosure is required whenever a settlement service provider involved in a RESPA covered transaction refers the consumer to a provider with whom the referring party has an ownership or other beneficial interest.

Regulatory authority: Regulation X, 3500.15

(iv) National Credit Score Disclosure and Notice to Home Loan Applicant

Examiner:

- 1) Verify the credit score disclosure was provided to the borrower(s) in a reasonable timeframe.
- 2) Assure the required contents (Notice to the home loan applicant) are included.

Any person who makes or arranges loans and who uses a consumer credit score in connection with an application that is to be secured by one to four units of residential real property must provide the consumer as soon as reasonably practicable a copy of the "Notice to the Home Loan Applicant,"* as well as the name, address, and telephone number of each consumer reporting agency providing a credit score that was used. Enclosed is an example of an acceptable form that meets the disclosure requirement.



NAMB National Credit
Score Disclosure.pdf

(Double-Click to Open)

*Regulatory Authority: 1) FCRA 15 USC 1681g,(1)(d).

(v) Privacy Policy Disclosure

Examiner:

Review the privacy disclosure for the following content:

- 1) The types of information that will be collected.
- 2) Types of information that will be shared with non-affiliated third parties.
- 3) An explanation of how they safeguard the information.

The initial disclosure must also contain an opt-out notice if the company shares non-public personal information with nonaffiliated third parties. An opt-out notice explains to the customer the types of information that will be shared, as well as the third parties who will receive the

information. It also gives the consumer the opportunity to decide whether he or she wants this type of information to be shared.

Verify the Opt-Out notice includes:

- 1) That you disclose or reserve the right to disclose nonpublic personal information about your consumer to a nonaffiliated third party;
- 2) That the consumer has the right to opt-out of that disclosure; and
- 3) A reasonable means by which the consumer may exercise the opt-out right.

Regulatory Authority: 1) Regulation P, Part 216.4 through 216.9

(vi) USA PATRIOT Act Information Form

Examiner:

Verify the information form includes:

- 1) A copy of the borrower(s) identification and information required in the USA PATRIOT Act form.



USA PARTIOT Act
Info Form.pdf

(Double-Click to Open)

Regulatory Authority: USA PATRIOT Act Section 326(a)(2)

Minimum Requirements

The regulations require financial institutions to implement reasonable procedures that ensure compliance and provide for:

- (a) verifying the identity of any person seeking to open an account to the extent reasonable and practicable;
- (b) notifying customers that their identity will be verified;
- (c) maintaining records of the information used to verify a person's identity, including name, address, and other identifying information; and
- (d) consulting lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency to determine whether a person seeking to open an account appears on any such list.

(vii) Notification of Action Taken Disclosure

Examiner:

When the MB is a Creditor per the Equal Credit Opportunity Act (ECOA)

- 1) Determine if the mortgage broker acts as a creditor*.
- 2) Assure the broker provides adverse action notifications.
- 3) Assure that the broker provided notifications as required under the FCRA.

*Under ECOA;

The term “creditor” means a person who, in the ordinary course of business, regularly *participates* in a credit decision, including setting the terms of the credit. The term creditor includes a creditor's assignee, transferee, or subrogate who so participates. Mortgage brokers

who do not participate in the making of a credit decision are not required to give notifications as required in 202.9.

*Under the Fair Credit Reporting Act (FCRA);

The term "creditor" means any person who regularly extends, renews, or continues credit; *any person who regularly arranges for the extension, renewal, or continuation of credit*; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit.

The ECOA requires disclosure of the principal reasons for denying or taking other adverse action on an application for an extension of credit. The FCRA requires a creditor to disclose when it has based its decision in whole or in part on information from a source other than the applicant or its own files. Disclosing that a credit report was obtained and used in the denial of the application, as the FCRA requires, does not satisfy the ECOA requirement to disclose specific reasons. For example, if the applicant's credit history reveals delinquent credit obligations and the application is denied for that reason, to satisfy [§202.9\(b\)\(2\)](#) the creditor must disclose that the application was denied because of the applicant's delinquent credit obligations. To satisfy the FCRA requirement, the creditor must also disclose that a credit report was obtained and used in the denial of the application.

*Regulatory Authority: 1) Regulation B, Equal Credit Opportunity Act (15 USC 1691), 202.9 Notifications, 2) Fair Credit Reporting Act (FCRA), 15 U.S.C.

4. Mortgage Broker Working Papers

The following work-papers are reviewed to ensure they are appropriate to the transaction and do not indicate deceptive or fraudulent activity.

a. Preliminary Commitment for Title Insurance

Examiner:

- 1) Check the date on the title report to better understand the original timeline of the transaction.
- 2) Review the original loan amount requested.

The title report contains information on the property to be secured by the proposed loan. The vested owner of the property is disclosed in Schedule B. Schedule B also provides lien information on the property. Tax assessments are disclosed prior to liens, which are typically listed in the order that they were recorded. When the servicing of the loan is sold an assignment of the deed of trust will also usually appear under the lien. An abbreviated property description is also provided in the schedule.

b. Appraisal

Examiner:

- 1) Review appraisal for value information and assure it matches what is on the other documentation in the file.
- 2) If the same appraiser is being used consistently, seek explanation.

As part of the processing of a loan the mortgage broker will order a property valuation through different methods. The most popular method is a full Uniform Residential Appraisal Report that is ordered through a licensed Real Estate Appraiser. Lenders are increasingly utilizing automated valuation reports. Automated Valuation or short form appraisals are most commonly used through Fannie Mae underwriting models on non-cash-out refinances where the lenders risk is decreased due to credit and mortgage history.

c. Credit Insurance Products

Examiner:

- 1) Review files for documentation of credit insurance products offered.
- 2) Ask the designated broker if credit insurance products are offered.
- 3) If credit insurance products are offered, assure they are correctly offered*.

Typically mortgage brokers do not sell these products unless they are conducting business under the Consumer Loan Act and authorized by the director. "Insurance" means life insurance; disability insurance, property insurance, involuntary unemployment insurance, and such other insurance as may be authorized by the insurance commissioner as defined in the Consumer Loan Act

*Noncredit insurance: A licensee may include the premiums for noncredit insurance in the principal amount of the loan, provided that purchase of the insurance is not required to obtain a loan and that this fact is disclosed to the borrower in writing. Also, the consumer must be given 60 days to review the insurance policy.

d. Hazard Insurance

Examiner:

- 1) Review files to determine if one insurance provider is used consistently.
- 2) Request clarification from the designated broker if any patterns are discovered.

The mortgage broker cannot steer the borrower(s) into any particular agent for homeowners insurance. A mortgage broker ordinarily makes contact with the agent of the borrower's choice and provides the loss payee information of the lender. This is usually one of the last steps prior to requesting the loan documents from the lender.

e. Flood Certification

Examiner:

- 1) Determine if the broker is completing the flood insurance check for the lender.
- 2) Assure the broker is disclosing the flood certification to the borrower (if applicable).
- 3) Verify flood insurance was acquired by the borrower from a provider they chose (if applicable).

The lender is required to determine if a property is in a designated flood zone. The trend of the mortgage broker requesting a flood determination is not very common in today's market. If a borrower's property is in a designated flood zone, the property will be required to have a flood insurance policy. This insurance must be of the borrower's choosing, as with other insurance products required in the making of a loan.

5. Funding Documents

a. Final Settlement Statement

Examiner:

- 1) Compare the fees on the final settlement statement with the fees disclosed on the GFE.
- 2) Request explanation on any large discrepancies.

The final settlement statement is the document the borrower signs at closing that details all fees paid in conjunction with the loan. It should mirror the GFE in the placement, type, amount, and payee on all fees in the transaction. Regulation X, Part 3500 Appendix A, provides instruction for the placement and disclosure of certain fees on the settlement statement.

b. Loan Fee Test for Re-Disclosure

A mortgage broker or loan originator on behalf of a mortgage broker shall not charge a fee that inures to the benefit of the mortgage broker if it exceeds the fee disclosed on the written disclosure pursuant to RCW 19.146.030(4)(a).

Examiner:

- 1) Test the disclosures for fee changes after the initial disclosure that may have inured to the benefit of the MB.
- 2) Use the loan fee test to verify compliance.



Loan Fee Test

(Double-Click to Open)

c. Note and Riders

Examiner:

- 1) Review the *note and any attached riders for discrepancies between the product originally disclosed and the product received at closing.
- 2) Verify disclosure of the new product if there are discrepancies.
- 3) Check for prepayment penalties and ARM terms.

The note is the description of the product and terms that the borrower actually received. It contains information on the principal amount, interest rate, interest rate change information (if it is an ARM), consummation and maturity dates, first payment date, and other pertinent information. Certain information, such as prepayment penalty terms and ARM terms is often disclosed in a rider to the note rather than in the note itself.

* Examiners should be aware that the note, deed of trust and riders are not currently required to be retained by the MB.

d. Notice of Right to Cancel

Examiner:

- 1) Determine if the broker is required to provide this notice*.

- 2) If the mortgage broker is required to give this notice, verify it was provided to the consumer and that the notice has accurate dates.

*The notice is not required unless the mortgage broker is funding the loan. This document is provided on both first and second lien refinanced mortgages when the borrower's primary residence is used to secure the loan. The borrower is to be given a period of three business days to rescind the transaction starting the day of delivery. The instructions provided in Regulation Z outline the required disclosures that must be on the rescission document.

Regulatory Authority: 1) Regulation Z 226.23(a)(3); 2) 226.23(a)(4)(b)(1).

G. Business Practices

1. Standards for Safeguarding Customer Information

Examiner:

- 1) Review the MB's information security program to assure customer information is secure.
- 2) Ensure the information security program meets the requirements set forth by the Gramm-Leach Bliley Act.
- 3) Carefully examine for the following deficiencies:
 - Computers are not password protected.
 - Employee safeguard of records training has not taken place.
 - Information systems, including network and software design, as well as information processing, storage, transmission and disposal do not have safeguards in place.
 - Detecting, preventing and responding to attacks, intrusions, or other systems failures are not addressed in the MB policies.

Regulatory Authority: 1) 16 C.F.R., Part 314.3

2. Home Mortgage Disclosure Act (HMDA)

Examiner:

- 1) Verify if the broker makes a credit decision on behalf of an investor
- 2) Verify if the credit decision is being made, but without the investor's review prior to closing, the broker has made the credit decision.

Who reports HMDA data for brokered loans?

The party making the credit decision must report HMDA data.

If the broker makes the credit decision based on an investor's loan policies, it reports that decision. If the investor makes the credit decision, it reports. For example, if the broker reviews an application, decides the application will meet the investor's approval criteria, and does not obtain the investor's review, the broker has approved the loan, and the broker must report the loan on its HMDA loan application record (LAR) as an approval, even if it forwards the application to the investor for final processing. The investor reports the loan on its HMDA LAR as a purchase.

If the broker decides an application will not meet the investor's approval criteria, it has denied the loan and the broker must report the loan on its HMDA LAR as a denial. In this situation, the investor has no HMDA LAR reporting requirement. The investor didn't make a credit decision or purchase a loan.

For additional clarification, consider the following scenarios:

(A) A broker makes credit decisions based on an investor's loan policies but without the investor's review prior to closing, and then forwards approved loans to the investor.

- Broker approved loans.
 - Broker – reports approval on HMDA LAR.
 - Investor – reports purchase on HMDA LAR.
- Broker denied loans.
 - Broker – reports denial on HMDA LAR.
 - Investor – no HMDA LAR reporting requirement.

(B) A broker forwards all loan applications to the investor for credit decisions.

- Investor approved loans.
 - Broker – no HMDA LAR reporting requirement.
 - Investor – reports approval on HMDA LAR.
- Investor denied loans.
 - Broker – no HMDA LAR reporting requirement.
 - Investor – reports denial on HMDA LAR.

To avoid responsibility for HMDA reporting, the broker must forward all applications to the investor for credit decisions. If the broker makes a decision to deny a loan because it does not meet an investor's criteria or it makes a decision to forward an application because it meets an investor's criteria, it has made a credit decision and must report that application in its HMDA LAR.

In summary, a broker who makes a credit decision on an application reports that decision, regardless of whose loan policies it bases the credit decision on and whose name the loan closes in, as shown in scenario A, above. An investor who makes a credit decision on an application received from a broker reports the decision, the broker does not, as shown in scenario B, above. An investor who purchases a loan from a broker, however, reports it as a purchased loan, regardless of who made the credit decision, as shown in scenario A.

See Appendix D (Official Staff Commentary on Regulation C) in the *“Guide to HMDA Reporting, Getting It Right!”* for additional information on reporting brokered loans.

3. Telemarketing

Examiner:

- 1) Review any scripts, contracts, and procedures related to telemarketing for compliance¹.

The Telemarketing Sales Rule requires a mortgage broker that participates in telemarketing activities to maintain records and have them available for examination.

Regulatory Authority: 1) Chapter 87: Telemarketing and Consumer Fraud and Abuse Prevention and 6102: Telemarketing rules; 2) 16 CFR Part 310.5.

4. Advertising

Examiner:

Review any radio, television, telephonic, electronic, and written advertisements, for the following:

- 1) Date or dates of any publication.
- 2) Name of each periodical.
- 3) Broadcast station or telephone information line which published the advertisement.
- 4) In the case of a flyer or other materials; the dates, methods, and area of distribution.
- 5) Review all advertisements for compliance with regulation Z, Part 3500, 226.24.

The Act requires a MB to make available for twenty-five months copies of all advertisements placed by or at the request of the MB which mention rates and fees.

Per WAC 208-660-350(26) Loan Originators must, “include your license number immediately following your name on solicitations, including business cards, advertisements, and residential mortgage applications.”

Regulatory Authority 1) 19.146.060(4)(a) and WAC 208-660-440

5. Business Name Use

Examiner:

- 1) Review all signage, advertisement, letterhead, stationary, and forms for names approved by the Director.
- 2) If a branch office, verify that each branch office is identified as a branch or division of the main office on all signs, advertisement, letterhead, stationary and forms.

6. Trust Account Examination

Examiner:

- 1) Collect 12 months of bank statements, trust account deposit register, and copies of all validated deposit slips or signed deposit receipts for each deposit to the trust account
- 2) Collect 12 months of all invoices for payments made on behalf of a borrower including but not limited to payments for appraisals, credit reports, title cancellations, and verification of deposit
- 3) A ledger for the same 12 months of each trust account which must contain a separate sub-account ledger for each borrower
- 4) Collect 12 months general account bank statements with corresponding check register
- 5) Collect each of the 12 month’s trust account reconciliation
- 6) Use above materials to reconcile the trust account.

The Examiner should identify loans with trust account transactions and conduct a review of the trust account transaction from payment collection to the final disbursement of the sub account to verify no deficiencies exist. The following items may be needed to complete the review:

- The Final HUD Settlement Statement that coincides with the selected loans.
- A copy of the general account and trust account bank statements covering a full 90-day period.
- The detailed ledger for both the general and trust account.
- The trust account sub accounts.

- Invoices applicable to the sub account ledgers.
- Deposit slips applicable to the sub account ledgers.
- Monthly reconciliation for each month under review.

a. Reconciliation of Trust Account Check Register(s) to Bank Statements

- (i) Randomly select one month's bank statement(s)
- (ii) Obtain a copy of the MB's reconciliation for the matching month
 - (a) Compare adjusted bank balance to check register balance
 - (b) Review the age of outstanding checks
 - (c) Review other reconciling items for reasonableness

b. Review of Trust Account Bank Statements

- (i) Review the past year's bank statements for any irregularities which may include missing bank statements, unusual transactions, bank fees, NSF deposits, and negative bank balances.
 - (a) List any unusual transactions
 - (b) Note any bank fees charged to the account.
 - (c) List any NSF (returned) deposits
 - (d) Note any negative bank balances
 - (e) Determine if the trust account has been set up properly

c. Borrower Sub Account Reconciliation

- (i) Obtain the borrower sub account as of the date of the bank reconciliation
- (ii) Reconcile borrower sub account ledger balances to reconciled check register balance
- (iii) Review borrower sub account ledgers for negative balances
- (iv) Review borrower sub account ledgers for balances held in trust for extended periods of time.
 - (a) Determine the reason for client funds being held; review the loan file to verify the time line.
 - (b) Look for potential misuses of the trust account

d. Trust Account Check Register Review

- (i) Review and testing of receipts/deposits and disbursement/checks.
- (ii) Scan check register and note any unusual deposits and disbursements
- (iii) For the items selected, perform the following
 - (a) Identify borrower(s) making up deposit or the borrower whom the disbursement belongs.
 - (b) Determine that the deposits were client funds and were properly deposited into the trust account by tracing to written documentation if applicable.
 - (c) Determine each disbursement was made on behalf of the borrower by tracing to invoice(s) and reviewing documentation on HUD settlement statement.
 - (d) Note any exceptions or improper deposits or disbursements. If a significant number of exceptions are noted, expand sample size to determine the extent of problem.
- (iv) Note whether any broker personal or business transactions were found in the trust account.

e. General Account Check Register Review

- (i) Cash receipts/deposits procedures – testing for possible borrower funds paid or received in the general account.
- (ii) Review deposit procedures (walk through with broker)
- (iii) Scan account for unusual deposits in amounts equal to appraisal or credit report fees
- (iv) Scan account for disbursement to appraiser(s), credit reporting company, title company and other third party type services.
- (v) Note any exceptions or improper details

7. Non Trust Account Holders

Examiner:

- 1) Review three months of general account bank statements and the detailed ledgers.
- 2) Review deposits and payments for amounts equal to appraisal fees and credit reports (\$400 or \$17).
- 3) Verify that payments to appraiser and credit reporting companies come from the general account. Ensure that the cost was never passed through to the borrower(s) on the settlement statement.
- 4) Review HUD settlement statements to verify that third party payments are being paid out directly to the third party.
- 5) Verify the accuracy of disbursements itemized on the HUD settlement statement from escrow to ensure they did not include third party services. This can be done by reviewing daily deposits, and the loans included in the deposit.

H. Detecting Predatory Lending

Predatory mortgage lending involves a wide array of abusive practices. Here are brief descriptions of some of the most common abusive practices and examination techniques used to identify them.

1. Equity Stripping

The lender makes a loan based upon the equity in your home, whether or not you can make the payments. If you cannot make payments, you could lose your home through foreclosure.

Examiner:

- 1) Follow the instructions for a net tangible benefit test as provided in the bottom of this section.

2. Excessive Fees

Points and fees are costs not directly reflected in interest rates. Because these costs can be financed, they are easy to disguise or downplay. On competitive loans, fees below 1% of the loan amount are typical. On predatory loans, fees totaling more than 5% of the loan amount are common.

Examiner:

- 1) Review the GFE and HUD settlement statements for fees that exceed five percent in aggregate of the loan amount, the examiner should include the yield spread premium fee earned on the loan also.
- 2) A trend of fees earned should be reviewed and noted in the report of examination.
- 3) You may also expand the scope of the examination so that branch or loan originator excessive fee trends can be reviewed.

3. Abusive Prepayment Penalties

Borrowers with higher-interest subprime loans have a strong incentive to refinance as soon as their credit improves. However, up to 80 percent of all subprime mortgages carry a prepayment penalty -- a fee for paying off a loan early. An abusive prepayment penalty typically is effective more than three years and/or costs more than six months' interest. In the prime or conforming market, only about 2 percent of home loans carry prepayment penalties of any length.

Examiner:

- 1) Review TIL disclosures, rate sheets, document request forms, and the note if applicable to reveal the pre-payment penalty charged in the transaction.
- 2) Look at the prepayment penalty; does it exceed the fixed portion of an adjustable rate mortgage transaction?
- 3) Was the prepayment penalty charged as an incentive to increase the yield spread premium received on the loan? For example, if a borrower is given an ARM with an initial fixed period of two years, was the borrower given a three year prepayment penalty?
- 4) Look at the initial rate sheet, lenders may compensate the mortgage broker for the additional years of prepayment penalty through a yield spread premium incentive.

4. Yield Spread Premiums

When a mortgage broker delivers a loan with a much higher interest rate (i.e., higher than the *par rate* that the lender has made available), the lender pays a "yield spread premium" to the mortgage broker. This is an indirect cost to the borrower for accepting the loan at a higher than par interest rate; and in return the borrower is expected to pay lower up-front costs.

Examiner:

- 1) Review the rate sheet used to derive the initial pricing.
 - 2) Compare the final settlement statement with the initial disclosure.
 - 3) Review the MB document request sheet delivered to the lender for pricing details.
 - 4) Compare the document request sheet to the most recent disclosures to verify consistency.
 - 5) Ensure any changes in points, interim interest, conditions, and terms were disclosed to the borrower(s).
 - 6) Review the GFE for YSP disclosure.
 - 7) Did the MB use a range or the actual amount of the YSP calculated using the initial rate sheet?
- When a MB creates the initial disclosure for a borrower, sufficient information required for disclosing interest rate, terms, and prepayment penalty is gathered from the lender (if the MB is not also the lender) so that MB or the loan originator acting on behalf of the MB can make accurate disclosures. Therefore, when the MB discloses an interest rate to a borrower, the estimated dollar amount of the YSP is known and should be disclosed on the initial disclosures. A review of the initial rate sheet provided by the lender, which must be maintained with the initial disclosure, will verify this information.
 - Examiners, Professionals and Specialist should be aware of the background on YSP and the 2001-1 Statement of Policy issued by HUD.
 - The Mortgage Brokers Practices Act (Act) and Rules do not specify the disclosure requirements or intended use of the YSP. Examiners should follow the guidelines given by Federal law. It is a violation of RCW19.146.0201(6) to fail to make these disclosures. If a company is found to be in violation of the disclosure or intended use of YSPs as addressed in Regulation X and HUD's policy

statement, the company will be cited as further discussed below in the deceptive practices section. In an examination, fees that are not disclosed and inure to the benefit to the broker will be refunded to consumers.



HUD's Statement of
Policy Letter on YSP

(Double-Click to Open)

YSP Predatory Lending and Deceptive Practices Recognition and Test

Examiners must review loan files for the following trends:

- 1) Does the MB charge the borrower(s) a Mortgage Broker Fee and receive an YSP?
 - 2) Is the MB using the YSP to reduce the up-front cost to the borrower?
 - 3) Do Loan Originators receive YSP income as part of the compensation from a MB?
 - 4) In a declining interest rate market was the initial rate at application the same as at funding?
 - 5) Did the YSP increase after the date of initial disclosure?
 - 6) Examiners will review the rate sheets on the loan sample to detect declining interest rates, increased margins on ARMs, and prepayment penalty add-ons which can all affect the amount of YSP received by the MB.
- The Examiner shall comment on the use of YSP and SRP in the Internal Routine and Controls section of the Report of Examination.
 - When the examiner finds that the YSP or SRP are not being disclosed they will site violations per Regulation X, Part 3500, Appendix B: Illustrations of Requirements of RESPA and RCW 19.146.0201(7). REFUNDS WILL NOT BE REQUIRED ON THE INITIAL EXAMINATION. A repeat of this violation on any subsequent examination will be cause for a file search and refunds to consumers.
 - The mortgage broker's fee must be itemized in the Good Faith Estimate and on the [HUD-1 Settlement Statement](#). Other charges which are paid for by the borrower and paid in advance are listed as POC on the [HUD-1 Settlement Statement](#), and reflect the actual provider charge for such services. Also, any other fee or payment received by the mortgage broker from either the lender or the borrower arising from the initial funding transaction, including a servicing release premium or yield spread premium, is to be noted on the Good Faith Estimate and listed in the 800 series of the [HUD-1 Settlement Statement](#). When the examiners find that the YSP or SRP increased without redisclosure and a written explanation, in a deceptive or exploitative manner (fees that inure to the benefit of the MB). The Examiner cites an apparent violation of RCW 19.146.030(4). The Department may also take action as prescribed in WAC 208-660-430(14)

Regulatory Authority: 1) Statement of Policy 2001-1 issued by HUD, 2) Regulation X, Part 3500, Appendix B, Illustrations of RESPA, 3) RCW 19.146.0201(6).

5. Loan Flipping

A lender or mortgage broker “flips” a borrower by refinancing a loan to generate fee income without providing any net tangible benefit to the borrower. Flipping can quickly drain borrower equity and increase monthly payments -- sometimes on homes that had previously been owned free of debt.

Examiner:

- 1) Review the credit report lines to verify any previous mortgage balances and loan history.
- 2) Verify the lien history on the title report.

- 3) Are borrowers being solicited within twelve months of the last transaction?
- 4) If it appears that the previous mortgage payment vs. the new mortgage payment did not benefit the borrower, conduct a net tangible benefit analysis as described in the following section.
- 5) Lenders and mortgage brokers may disguise loan flipping by giving the borrower cash out, or paying off debt. A phone call to the borrower may be your only means to verify how the transaction was actually introduced to the borrower.
- 6) If the net tangible benefit analysis reveals trends in this area the examiner, professional or specialist may need to expand the scope of the examination.

6. Unnecessary Products or Packing

Sometimes borrowers may pay more than necessary because lenders sell and finance unnecessary insurance or other products along with the loan.

Examiner:

- 1) Review the loan for additional insurance and ancillary products being sold by the MB. If the MB sells additional products the examination should be modified to include verification of the disclosures, and an examination of the insurance and ancillary product penetration.

7. Bait-and-Switch Schemes

The lender may promise one type of loan, interest rate or fees but without good reason, give you a different one. Sometimes a higher (and unaffordable) interest rate doesn't kick in until months after you have begun to pay on your loan.

Examiner:

- 1) Review the loan documents to verify if the terms on the initial disclosures are consistent with the final disclosures.
- 2) Are the terms of the loan consistent with the credit scores, income and LTV the borrower should be getting?

I. Instructions for Net Tangible Benefit Examinations

Occasionally, a net tangible benefit exam will be conducted if it is deemed necessary by the EIC. In the event of a net tangible benefit examination, the following items must also be completed: by utilizing the documents from the loan that was paid off and the new loan when applicable:

Examiners should call borrowers and discuss the loan(s), to help determine the Net Tangible Benefit. Examiners should request the documents from the loan that was paid off and the new loan for a thorough analysis of both transactions.

Examiner:

- 1) Input the credit scores (from the credit report) under the explanation section of the Examination Worksheet.
- 2) In the before and after columns calculate the principal and interest, taxes, and any applicable insurances (PITI) from the loan contract, make a note in the explanation column if the taxes and insurance were or were not included in either the before or after PITI analysis.
- 3) Enter the payment of any other liens.
- 4) Enter the payment of any other debts listed on the credit report.

- 5) Enter the appraised value from the appraisal report.
- 6) Enter the 1st lien loan amount from the original loan in the before column and the new 1st mortgage amount in the after column.
- 7) Repeat the same action for any subordinate liens.
- 8) Enter the rate from the previous loan in the before column and the final rate of the new loan in the after column.
- 9) Verify if the prepayment penalty was disclosed on the initial TIL vs. the final disclosures comment any additional finding in the explanation section.
- 10) Review the loan documents to verify on both transactions if the initial request was for a fixed rate program and then it changed to an ARM program.
- 11) Were discount points charged to buy down the interest rate?
- 12) What was the cost to buy down the rate?

Review the Debt to income ratios, LTV, and CLTV. Did the loan benefit the borrower?



Net Tangible Benefit Test

(Double-Click to Open)

J. Detecting Fraud

Examiners will review the MB's business practices and loan files for activity that has been known to be associated with fraudulent activity. Reviewing the following elements of a transaction will assist the Examiner:



Mortgage Fraud Red Flags.doc

(Double-Click to Open)

Some loan products are more consistent with fraudulent lending activity and provide a conduit for fraud because they lack essential elements for qualifying for the loan. The Examiner should pay special attention for trends in special loan products such as:

1. No Documentation Loans

This loan product is associated with higher rates, and borrowing for individuals that may have a source of income and assets but cannot prove it in a conventional manner.

2. NINA or No Income No Asset Loans

Like No Documentation Loans, borrowers may have funds and income but not the ability to prove it due to time on the job or the length of time and source of the assets being used to qualify for the loan.

3. Stated Income Loans

This loan will be used frequently when the debt to income ratios for the borrower exceed what they should qualify for. Stated income may cause borrowers to qualify for more payment than they can

actually afford. Coupled with an ARM product this could cause the borrower later in the loan to not being able to afford the home.

4. Adjustable Rate Mortgages

ARM products are designed to assist borrowers that are educated as to how the products works and can afford them when market changes increase the payment. Too often they get the consumer into the loan but create an affordability issue for the consumer.

K. Provide EIC with Worksheets and Supporting Documents

Examiner:

- 1) Provide the EIC with all worksheets and supporting working papers.

L. Shipping Files to the Office

In State Examination

At the conclusion of the exam, the EIC will secure the loan files and transport them back to DFI. In the instance where air travel was required, the EIC ships the files by other means and obtains a receipt for reimbursement.

Out of State Examination

At the conclusion of the exam, the EIC requests the licensee to ship any requested files and documentation to the DFI office in order to compile the Final Report of Examination with its supporting documentation. If the licensee is unable to do this, the EIC ships the files by other means and obtains a receipt to bill the licensee.

M. Exit Meeting and Report

After you have provided all the requested information and the examiner has completed the preliminary analysis, which is typically the last day of the onsite examination, the EIC may conduct an exit meeting, which entails providing the licensee with an Exit Report and discussing the results of the exam up to that point. The Exit Report is similar in format to the Report of Examination, but it may change significantly in content and style before it is finalized. The exit meeting is a rather informal meeting where the licensee is provided with any major problems encountered during the exam so they have time to prepare responses while the Report is finalized. It is also an opportunity for the examiners and the licensee to ask any questions they may have at that point in time.

The Exit Report may also provide an explanation for expanding the time period for subsequent examinations due to findings identified during the examination.

IV. POST EXAMINATION PHASE

A. Examiners Provide Travel Cost Information to EIC (Out of State Examinations Only)

Examiner(s):

- 1) Provide EIC with the amounts of all incurred travel costs including airfare, parking, rental car, hotel, taxi, and other expenses necessary to the examination.

The EIC needs this information as soon as possible after returning to the office, as they must be included with the final report.

B. Write Report of Examination

EIC:

- 1) Write the Report of Examination (ROE) according to the Department’s report writing standards.
- 2) Post their final draft ROE on the internal file server.
- 3) Scan the examination and workpapers.
- 4) Organize the working papers in the examination folder and submit to the Secretary Administrative.

C. Determine Examination Rating

The Department’s Report of Examination will disclose the assigned rating in the Comments and Conclusion section under the sub section titled “Rating.” The EIC will rate MB’s on a scale of “1” to “5” depending on the severity of violation(s) cited in the examination and the MB’s internal control structure. With respect to a MB that is rated “2”, “3”, “4”, or “5”, report comments will appropriately elaborate on the particular deficiencies noted in the MB’s compliance program to further support the rating assigned and the recommendation of a subsequent examination. MBs that receive a “2”, “3”, “4”, or “5” rating, present risk that requires a subsequent examination to determine if recommendations based on the findings in the Report of Examination have been remedied.

The primary purpose of the rating system is to help identify those mortgage brokers whose compliance with consumer protection, statutes, and regulations displays weaknesses requiring special attention and which are cause for an additional examination to verify deficiency(s) have been resolved. In addition to the compliance ratings, greater supervisory concern and enforcement actions may result from consumer complaints and/or unlicensed activity disclosed either during or independent of the examination process.

D. Finalize Hours Recapitulation and Travel Costs Recapitulation for Invoicing

EIC:

- 1) Compile the total travel costs and number of hours used for the examination on the appropriate forms
- 2) Place a “DO NOT BILL” watermark on any invoices for in-state examinations*
- 3) Submit to supervisor for approval

*Licensees are not billed for travel expenses incurred during in-state examinations, these bills are for internal records only.

E. Final Review

Secretary Administrative:

- 1) Receive the final report folder and all working papers from the EIC.
- 2) Record the date received.
- 3) Assign it to the appropriate review examiner.

Review Examiner:

- 1) Review the report and make edits as necessary.

- 2) Provide the final report back to secretary administrative or management for issuance.

F. Final Report and Invoice Mailed to the Licensee

Secretary Administrative:

- 1) Mail a copy of the final Report of Examination and an invoice of travel costs (if applicable) along with a request for a response.

G. Response from the Licensee

Licensee:

- 1) Respond in writing within 30 days of the date the final ROE is issued.
- 2) Itemize each apparent violation with the proposed remedy and implementation date.
- 3) If refunds are required, provide copies of checks and accompanying letters sent to each borrower.

Review Examiner:

- 1) Review the response from the licensee and determine whether or not it is satisfactory.
- 2) Communicate further with the licensee if the response is deemed unsatisfactory.

H. Special Situations

Occasionally, special situations may arise where a licensee requires additional time to compile a response to the final report. If additional time is needed, the licensee may request, in writing, an extension for the response. This must be approved by a supervisor.

I. Reports by a Professional or Specialist

If the MB informs the Department that an examination has been conducted by a professional or specialist, the report must be sent to the Department by the professional or specialist along with supporting documentation. A staff reviewer will determine if the report meets the Department's standards and inform the MB as to any follow-up required.

J. Referral to Enforcement

If administrative action is required or if problems arise in an examination that requires investigation, the case may be turned over to the Department's Enforcement Unit to complete such actions.